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President Signs Emergency Tax Relief Act to Aid Katrina Victims, Volunteers And Donors; IRS Also Takes Action

Immediately after Hurricane Katrina hit, Congress appropriated \$10.6 billion for relief work. Congress has since added \$51.8 billion and is likely to appropriate even more. In addition to these huge appropriations, Congress has passed the Katrina Emergency Tax Relief Act of 2005 (H.R. 3768). The new law gives Hurricane Katrina victims—individuals and businesses—temporary tax breaks scored by the Joint Committee on Taxation at over \$6 billion.

Help for Individuals

The *Katrina Emergency Tax Relief Act of 2005* contains tax breaks not only for victims of the disaster but also for individuals and businesses helping in the recovery. Sen. Max Baucus, D-Montana, predicted that the new law is just the beginning. “Additional legislation is being readied that will facilitate reconstruction, spur economic development and address the needs of the working poor.”

Casualty losses

The new law lifts all casualty loss restrictions for victims for Hurricane Katrina. Generally, nonbusiness casualty losses are deductible only to the extent losses are deductible only to the extent they exceed: (1) 10 percent of the taxpayer’s adjusted gross income and (2) a \$100 floor. Casualty losses that arise in the Hurricane Katrina disaster area on or after August 25, 2005, and that are attributable to Hurricane Katrina are not subject to these restrictions.

Preserving tax benefits

Many of the evacuees from the Gulf Coast left home with very little. Not only are they homeless, many are jobless. Relocation and a change in employment affect a person’s tax status. Hurricane Katrina victims can, if they choose, use their 2004 income to calculate the child credit and the earned income tax credit for a tax year that includes August 25, 2005. To be eligible, taxpayers must have lived in (1) the core disaster area or (2) the Hurricane Katrina disaster area and been displaced from his or her home by reason of Hurricane Katrina, as of August 25, 2005. In addition, the earned income for 2005 must be less than 2004 earned income. For tax years beginning in 2005 or 2006, the IRS is authorized to make adjustments in the application of the tax laws necessary to ensure that taxpayers do not lose any deduction or credit or experience a change in filing status by reason of temporary relocations caused by Hurricane Katrina. Any such adjustment must also ensure that an individual is not taken into account by more than one taxpayer with respect to the same tax benefit. The JCT explanation points out that such adjustments may include addressing the application of the residency requirements relating to dependency exemptions.

Extended tax deadlines

After Hurricane Katrina hit the Gulf Coast, the IRS extended tax filing and payment deadlines to January 3, 2006. Congress is now giving affected taxpayers even more time. Qualifying taxpayers have until February 28, 2006, to file any returns and pay taxes for any period that had not expired before August 25, 2005.

Early distributions from IRAs and pensions

Early distributions from IRAs, 401(k) plans, and other retirement savings vehicles are usually discouraged and taxpayers risk penalties for making early distributions unless there are special circumstances. The new law relaxes the tough restrictions for qualified Hurricane Katrina distributions.

Penalty-free withdrawals. Victims may withdraw up to \$100,000 from an IRA, 401(k) plan, or similar savings plan without penalty for distributions made on or after August 25, 2005, and before January 1, 2007. Qualifying victims must have had their principal home in the Katrina disaster area on August 28, 2005, and must have sustained an economic loss. (The \$100,000 limit is applied for each taxpayer and not to each retirement account.)

Extended rollover period. Taxpayers who are able to repay the distributions have three years to put the funds back and generally qualify for rollover treatment. Otherwise, they will be taxed on their deductions.

Additionally, taxpayers who withdrew funds from an IRA after February 28, 2005, and before August 29, 2005, for a first-time home purchase but who could not complete that purchase, because of Hurricane Katrina, may put the funds back in their IRAs without penalty, if done by February 28, 2006.

Three-year income averaging

Taxpayers who cannot avoid income tax on their penalty-free withdrawals are allowed to spread that income evenly over three years (unless they elect out of this special treatment).

Discharge of indebtedness

A discharge of indebtedness generally is taxable. The new law removes this restriction for victims of Hurricane Katrina whose principal residence on August 25, 2005, was located in the core disaster area or in the Hurricane Katrina disaster area (but outside the core area) and who suffered economic loss. The debt provision applies to discharges made on or after August 25, 2005, and before January 1, 2007.

**Charitable Contributions
and Actions**

Giving shelter to evacuees

Americans have opened their homes in unprecedented numbers to give shelter to evacuees. The new law rewards those generous homeowners (and renters) with a special tax deduction for tax years beginning in 2005 or 2006. Individuals who use their principal residence to provide housing free of charge to evacuees (referred to as Hurricane Katrina displaced individuals) for at least 60 consecutive days may claim a special \$500 deduction from taxable income for each evacuee residing in the taxpayer's home. The deduction is capped at \$2,000 total and may be claimed once for all tax years (which effectively limits it to providing shelter for four evacuees). The shelter also must be in the taxpayer's principal residence. In addition, the evacuee's principal place of abode must have been in the Hurricane Katrina disaster area as of August 28, 2005.

The income-based phase outs applicable to other exemptions do not apply to the special Hurricane Katrina exemption.

Charitable contributions

Generally, for individuals, contributions to tax-exempt charitable organizations are limited to 50 percent of the taxpayer's contribution base (adjusted gross income) for the tax year. Any excess amount may be carried over for a period of up to five years. The new law removes the 50 percent limitation for all cash donations to a charitable organization described in Code Sec. 170(b)(1)(A) (other than a supporting organization described in Code Sec. 509(a)(3)) for the period beginning on August 28, 2005, and ending on December 31, 2005. Under the provision, an individual's deduction for qualified contributions is allowed up to the amount by which the taxpayer's contribution base exceeds the deduction for other charitable contributions. Contributions in excess of this amount are carried over to succeeding tax years. The provision also exempts those donations from the application of the phase-out of itemized deductions for high-AGI taxpayers. A taxpayer must also elect to have contributions treated as qualified contributions under these provisions.

Mileage reimbursement

Taxpayers using a personal vehicle for any charity work may claim a tax deduction of 14 cents per

mile in lieu of a deduction based on actual expenses. The new law raises the statutory standard mileage rate for charity work related to Hurricane Katrina to 70 percent of the standard business mileage rate for the period beginning on August 25, 2005, and ending on December 31, 2006, rounded up to the next highest cent. The standard business mileage rate is 40.5 cents-per-mile through August 31, 2005. The standard business mileage rate is 48.5 cents/per/mile for the September 1 to December 31, 2005 period. Therefore, the new mileage rate for charity work related to Hurricane Katrina is 29 cents-per-mile during the period of August 25, 2005, through August 31, 2005. The new mileage rate for charity work, therefore, is 34 cents-per-mile from September 1 to the end of the year. It will be adjusted for 2006 once the IRS releases the 2006 mileage rates later this year.

If the taxpayer is a volunteer and he or she is reimbursed for the costs of using a passenger automobile in connection with providing relief to Hurricane Katrina victims, the reimbursement received from an organization described in Code Sec. 170(c) is excluded from his or her income up to the amount that equals the full standard business mileage rate. This exclusion provision applies to automobile usage during the period beginning on August 25, 2005, and ending on December 31, 2006.

Reminder. Parking fees and tolls may also be deducted separately by taxpayers claiming the statutory standard mileage rate for charity work. Volunteers who drive from their home states to the Katrina disaster area presumably are covered for that leg of their journey as well as for vehicle use while in the disaster area.

IRS Responds To Katrina

In a series of rapid-fire announcements immediately after Katrina, the IRS has:

- Extended filing and payment deadlines;
- Allowed employees to donate leave to help victims;
- Set up a toll-free number for taxpayer assistance;
- Partnered with tax professionals to help victims;
- Extended Form 5500 qualified plan deadlines;
- Extended minimum funding plan contribution deadlines;
- Raised the standard mileage rate;
- Given relief workers some help;
- Expedited charity applications